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SUBJECT: SOUTH AFRICA: SCENESETTER FOR VISIT OF CODEL
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Distribution.

12. (SBU) Welcome to South Africa. In the twelve years since the end of apartheid, the South African government (SAG) has taken major steps toward establishing a democracy and market-based economy. Despite problems of income inequality and poverty, a severe HIV/AIDS pandemic, and political tensions within the ANC, South Africa remains the continent's best prospect for an economically prosperous democratic country. President Mbeki's visit to the White House in June 2005 reinforced our good bilateral relations. We share important goals on the African continent, particularly in the area of conflict resolution. While South Africa's involvement in global issues, such as Haiti, North Korea and Iran, are not always in sync with U.S. interests, bilateral cooperation in other areas has helped to advance the U.S. global agenda.

13. (SBU) Since 1994, the United States Government has contributed approximately \$1.2 billion toward South Africa's development, excluding \$201 million in credit guarantees. Over two dozen U.S. agencies, including the Office of Technical Assistance at Treasury, U.S. Secret Service, Customs, Peace Corps, Foreign Agriculture Service, Health and Human Services, and USAID are represented within our Mission, which includes the embassy in Pretoria and consulates in Johannesburg, Cape Town, and Durban.

14. (SBU) In this message, we provide a brief overview of the major issues facing South Africa and key concerns in U.S.-South Africa relations.

-- Political Overview: Democracy Won
-- Promoting Africa
-- The Economy
-- Bilateral Trade and Investment
-- OPIC Focus on Housing and Capital Markets
-- Combating the Finance of Terrorism
-- HIV/AIDS: A Crisis of Epic Proportions

POLITICAL OVERVIEW: DEMOCRACY WON

15. (SBU) The African National Congress (ANC) dominates the South African political scene. The party controls 293 of 400 seats in the National Assembly and leads the administrations in all nine provinces. In municipal elections held on March 1, the party extended its dominance over government, capturing the outright majority in 214 of 284 municipal

councils. The ANC operates as a tripartite alliance among ANC stalwarts, the South African Communist Party (SACP), and the Congress of South African Trade Unions (COSATU). In recent years, schisms have begun to appear as the SACP and COSATU have become more vocal in their opposition to the government's economic, HIV/AIDS, and Zimbabwe policies, and as a result of tensions over the dismissal of former Deputy President Zuma and subsequent trials for corruption and rape. These tensions are surfacing at the same time with increasing dissatisfaction at the grass roots level over the poor delivery of public services. Notwithstanding these pressures, the alliance is likely to hold together, at least in the short term.

¶6. (SBU) Thabo Mbeki was elected president in June 1999 and began his second five-year presidential term in April 2004. During his tenure, he has shifted the focus of government from "reconciliation" (binding together of the body politic and society across racial groups) to "transformation" (transforming political and economic relationships to reflect the society's racial make-up), particularly on the economic front through affirmative action, i.e., "Black Economic Empowerment" (BEE). Progress on developing a comprehensive BEE policy for the private sector, however, has been slow.

PROMOTING AFRICA

¶7. (SBU) South Africa has taken a high-profile role in promoting Africa's development and engagement with the rest of the world. Until July 2003, South Africa served as the first chair of the African Union (AU) and currently holds the chair of the G-77. Since becoming president seven years ago, President Mbeki has been invited to participate on the

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subject of African development at each successive G-8 Summit. He continues to be the driving force behind the New Partnership for Africa's Development (NEPAD), an AU program to strengthen political governance and promote regional economic development. As Chair of the Joint World Bank and International Monetary Fund Development Committee from April 2002 to September 2005, South African Finance Minister Trevor Manuel also has figured prominently in the international dialogue on Africa. On the political side, President Mbeki and his top aides have devoted considerable resources to ending Congo's civil war and to the Burundi peace process. President Mbeki mediated in Cote d'Ivoire and provided support to the AU's Mission to Sudan. In Zimbabwe, however, President Mbeki's "quiet diplomacy" has not produced any discernible result, nor has a bilateral effort to negotiate political conditions on a bailout loan. Notwithstanding, South African officials still argue that additional pressure, such as economic sanctions, would be ineffective, risk destabilizing Zimbabwe, and create spillover problems for South Africa.

THE ECONOMY

¶8. (SBU) As the dominant and most developed economy in sub-Saharan Africa, South Africa has little in common with the other countries of the region. An upper middle income, emerging market economy with GDP per capita of \$5107 (2005), South Africa may have more in common with Chile, Malaysia, and Thailand. On the other hand, a large segment of South Africa's population lives in typical third world poverty. The National Treasury under Finance Minister Trevor Manuel and the independent South African Reserve Bank (SARB) under Governor Tito Mboweni have pursued fiscal and monetary policies that have resulted in increasing economic growth within a moderately inflationary environment. The government has steadily reduced the fiscal deficit from nearly 6.0% of GDP in 1994-95 to 0.5% in 2005-06. Robust tax collections have consistently reduced the forecast deficit the past several years. In 2006-2007, the Treasury forecasts that its

moderately expansionary budget will produce a 1.5% deficit. Dedicated to inflation control, the SARB has reduced the consumer price index minus mortgage costs from 12.4% at the beginning of 2003 to 4.3% in January 2006, well within the SARB's target range of 3-6%. In the meantime, real GDP growth has climbed from 3.0% in 2003 to 4.9% in 2005, mostly as a result of strong consumer spending by an emerging black middle class.

¶9. (SBU) South Africa's greatest economic challenges are accelerating growth, alleviating unemployment, and reducing income inequality between white and black South Africans. The official unemployment rate of 26.7% is significantly higher among black South Africans than whites. Moreover, 56% of black South Africans, as opposed to just 4% of whites, live in poverty. To achieve its target growth rate of 6% and create jobs, the government believes that it must increase public sector spending on economic infrastructure, encourage labor-intensive industries, and promote the development of small business. To increase the black employment and reduce income inequality, the government believes that it must implement a comprehensive affirmative action policy, improve programs for skills development, and continue to improve the quality of life for the nation's poor through transfer payments and the provision of public services such as water, electricity, and housing. Since 1994, nearly 1.8 million low-cost homes have been built and ten million people have been connected to clean water. In addition, the government wants the poor to have greater access to the modern economy in areas such as finance. This has led to the "Big 4" banks (Standard, Barclays/ABSA, FirstRand, and Nedcor, which together control 85% of the market) to agree to offering low-cost bank accounts to the poor and locating bank branches in low income areas.

BILATERAL TRADE AND INVESTMENT

¶10. (SBU) In June 2003, the United States launched bilateral free trade negotiations with the Southern African Customs Union (South Africa, Botswana, Lesotho, Namibia, and Swaziland). In 2004, negotiations stalled over the inclusion of chapters on services, investment, intellectual property rights, government procurement, labor, and environment. In December 2004, SACU trade ministers reaffirmed their commitment to a comprehensive agreement, but talks stalled

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again shortly after resuming in September 2005. On February 21, U.S. Trade Representative Portman sent a letter to each SACU trade minister explaining that it was unlikely that the two sides would be able to bridge their differences before Trade Promotion Authority expired in 2007. On April 18, Deputy U.S. Trade Representative Karan Bahatia will meet with SACU deputy ministers of trade to discuss the status of negotiations and U.S.-SACU trade relations.

¶11. (SBU) Because of the strong presence of U.S. companies in South Africa and unilateral trade preferences provided to South Africa under the African Growth and Opportunity Act, U.S.-South Africa bilateral trade has grown steadily over the past five years. In 2005, total bilateral trade reached \$9.5 billion, up 7.0% from the year before, and approximating that of Norway or Chile. U.S. exports to South Africa grew 23% to \$3.7 billion, once again making South Africa our largest export market in sub-Saharan Africa -- twice that of Nigeria. The only negative development was a slight decline in South African exports to the United States, to \$5.9 billion. This was because of the adverse effect of Chinese competition on South African exports of clothing to the United States after the expiration of the Agreement on Textiles and Clothing, and the continued strength of the rand vis-a-vis the dollar.

¶12. (SBU) After a surge in the mid 1990's, U.S. foreign direct investment in South Africa has reached a plateau, a trend that has been true for other investing countries. With

the notable exception of two large British acquisitions in 2005, South Africa has been unable to attract its fair share of foreign direct investment. Reasons often cited are a high crime rate, poor governance, uncertainty surrounding BEE policies, inflexible labor regulations, the dominance of state owned enterprises and other monopolies in certain sectors, and the prevalence of HIV/AIDS. Nonetheless, the United States is still the second largest foreign direct investor in South Africa (\$5.0 billion at year-end 2004), and by far the largest portfolio investor (\$22.5 billion year-end 2004, i.e., 41% of all foreign portfolio investment). Almost 600 U.S. firms have a presence in South Africa, with the vast majority treating the country as a base for regional business. With a market capitalization of \$650 billion. South Africa's JSE Securities Exchange is 17th largest in the world.

OPIC FOCUS ON HOUSING AND CAPITAL MARKETS

¶13. (SBU) The Overseas Private Investment Corporation (OPIC) has initiated a number of investment funds that benefit South Africa. OPIC is about to lend \$250 million for the start up of two additional investment funds, one focused on the South African market and the other on emerging African markets. To help South Africa contend with a deficit of 2.4 low income million homes, OPIC provided a \$15 million loan guaranty to finance home construction and a \$250 million loan guaranty to mitigate the risk of mortgage default for HIV-positive homeowners. On May 2-4 in Cape Town, OPIC will host a conference on housing in Africa to promote housing construction and finance on the continent.

COMBATING TERRORIST FINANCE

¶14. (SBU) South Africa has been building its capability to combat money laundering and terrorist finance since September 11, 2001. In 2003, the Financial Intelligence Centre (FIC) was established to monitor suspicious financial transactions.

In 2005, South Africa's Protection of Constitutional Democracy Against Terrorist and Related Activities Act came into force, thus criminalizing terrorist activity and granting government the power to seize assets belonging to terrorists. Also in 2005, South Africa assumed the one-year presidency of the Financial Action Task Force. While cooperation with us has been very good when it comes to terrorist finance, officially South Africa only takes action against an individual or organization after it has been listed by the United Nations Sanctions Committee under Resolution 1267. FinCEN is close to concluding a Memorandum of Understanding with the FIC that will facilitate greater exchange of information between the two organizations.

HIV/AIDS: A CRISIS OF EPIC PROPORTIONS

¶15. (SBU) South Africa has the largest number of HIV

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infections in the world, and HIV/AIDS is the country's leading cause of death. Well over five million South Africans are HIV-positive, including 2.9 million women. The number of AIDS-related deaths and AIDS orphans is expected to climb by 2010 to 5.2 million and 1.5 million respectively. The U.S. Census Bureau estimates that South Africa will have negative population growth and a 25% decrease in life expectancy by 2010, if nothing is done. President Bush's Emergency Plan for AIDS Relief (PEPFAR), in its third year of implementation, is working with public and private sector prevention, treatment, and care programs. During the first two years, the U.S. provided almost \$240 million through PEPFAR to support HIV/AIDS programs in South Africa, making it the largest recipient of Emergency Plan resources. PEPFAR funding for FY2006 will be more than \$220 million. After two and a half years of funding, the Emergency Plan supports more

than 50,000 in ARV treatment through programs it supports in all provinces. In addition, the South African military has expanded prevention programs and collaborates with the U.S. military and NIH on ARV-based AIDS treatment research (a \$45 million five-year program). Global Health, and HIV/AIDS in particular, is our highest Mission Performance Plan priority. South Africa also is a major recipient of Global Fund resources, of which about one-third is contributed by the United States.

TEITELBAUM